

## Assessment of Long-Term Fiscal Sustainability

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According to European Commission (EC) projections and the EC baseline scenario, Luxembourg is exposed to a high risk for long-term fiscal sustainability, a finding that is in line with the latest assessments of the National Council of Public Finance (CNFP) on the subject. As in the past, the greatest challenge for Luxembourg's public finances will be future expenditure linked to the ageing of the population. According to recent projections in the EC's Ageing Report 2024 (AR 2024), these expenditures are expected to rise from 15.7% of GDP in 2022 (30% below the EU average) to 24.9% of GDP in 2070 (slightly above the EU average), which represents an increase of around a third (9.2 % points of GDP). In terms of the public debt ratio, the threshold of 60% of GDP would be exceeded in 2049. Thereafter, the ratio would increase sharply to reach 223% of GDP in 2070. In order to stabilize the public debt ratio in the long term (long-term sustainability indicator "S2", fully explained in the assessment), a lasting improvement in the primary structural balance of +8.6 % points of GDP would be necessary, given that the latter is assumed to be -0.6% of GDP over the entire period covered in the EC scenario.

The finding of a high risk for long-term fiscal sustainability, based on the S2 indicator used in the analysis ( $S2 > 6$  % points of GDP) needs to be put into perspective. This is because the S2 indicator does not take into account 1) the increase in the contribution rate as soon as reserves fall below a certain threshold and 2) the pension reserves kept in the *Fonds de compensation* (which are, however, taken into account in the public debt projection by means of stock-flow adjustments). These reserves amounted to 26.25 billion euros in December 31<sup>st</sup>, 2023, higher than the level of general government debt, which was around 20 billion euros at the same time. Similarly, the various schemes (pensions, healthcare, long-term care) include the application of automatic stabilizers intervening at specific times, such as the tabling of a special bill to raise contribution rates as soon as reserves fall below certain thresholds, thus mitigating the increase in related budgetary costs.

The CNFP also notes that the theoretical assumption of "unchanged policy" (which translates into a constant primary structural balance of -0.6%) limits the plausibility of the EC's baseline scenario. Firstly, the constant structural balance used for the entire period under review on the basis of the EC's autumn forecasts for 2024 is relatively low (far from historical data and from the multi-annual financial programming for the 2023-2027 period, where the SSP would be +0.3%). The CNFP considers that the starting point for the budgetary situation should not depend on the cyclical situation in a given year to make long-term projections, especially if the impact of the starting situation on these projections is so high. Secondly, it is likely that measures will be taken by the public authorities in due course to counteract the projected developments. Other EC assumptions are highly uncertain (net migration, growth in cross-border employment), or even change from one Ageing Report to the next, with a significant impact on the outcome for the long-term sustainability of public finances (constant primary structural balance, cross-border employment, total factor productivity). In addition, the analysis of the plausibility of the EC baseline scenario shows that the projections would benefit from taking better account of Luxembourg's specific national characteristics.

These considerations led the CNFP to simulate several alternative scenarios in order to analyze the sensitivity of the results to the assumptions made. Of particular note is the scenario based on STATEC's long-term macroeconomic and demographic projections, using a methodology that links economic growth to population growth. According to this scenario, expenditure linked to the ageing of the population would increase at a slower pace than in the EC baseline scenario, and public debt would amount to 115% of GDP in 2070 (compared to 223% of GDP in the EC's baseline scenario). With an S2

indicator of 6.1 % points of GDP (vs. 8.6 % points of GDP in the EC baseline scenario), Luxembourg would still face a high risk for long-term sustainability of public finances ( $S2 > 6$  % points of GDP), but to a lesser extent. By also suggesting a constant primary structural balance of +0.5% of GDP instead of the -0.6% of GDP assumed in the EC scenario, the  $S2$  indicator would decrease to 5.0 % points of GDP, which would represent a medium risk for the sustainability of Luxembourg's public finances ( $S2$  between 2 and 6 % points of GDP). It should be noted, however, that the STATEC scenario used by the CNFP to draw up the alternative scenarios assumes a population of 1 300 000 people by 2070, and that such population growth implies other aspects not considered in the analysis, but which have repercussions on public finances (housing, infrastructure, etc.). In July 2024, the STATEC published new long-term projections, according to which the population should reach between 1 000 000 and 1 100 000 people by 2070.

In conclusion, the CNFP considers that Luxembourg faces a medium to high risk for long-term sustainability of public finances. However, it is important to bear in mind the limitations of an exercise based on more or less plausible demographic, economic and budgetary projections and assumptions established for a time horizon of around 50 years. However, the prospects for the long-term development of public finances must not be lost sight of when discussing issues that have an impact on intergenerational justice, including those linked to the ageing of the population.